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C O N F I D E N T I A L SECTION 01 OF 04 CARACAS 000157

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ENERGY FOR CDAY, DPUMPHREY, AND ALOCKWOOD
NSC FOR DTOMLINSON

E.O. 12958: DECL: 01/12/2017
TAGS: EPET ENRG EINV ECON VE
SUBJECT: OIL COMPANIES WEIGH THEIR OPTIONS

REF: A. CARACAS 83
¶B. 2006 CARACAS 910
¶C. 2006 CARACAS 784
¶D. CARACAS 112

Classified By: Economic Counselor Andrew N. Bowen for Reason 1.4 (D)

¶1. (C) SUMMARY: All six international oil companies (IOCs) with stakes in the four strategic associations met with the BRV last week and received a written proposal regarding the transition to PDVSA controlled joint ventures. The BRV is expected to give companies its estimates on the value of their investments in the next week. It also appears that the BRV is upping the negotiating pressure on ExxonMobil to decide where it wants to remain in Venezuela. It appears the BRV believes the whole migration process will take six months. IOC executives listed a number of concerns about the process. There are indications that the BRV would like to reduce the number of IOCs operating in the Faja.

THE UNNEGOTIATIONS BEGIN

¶2. (C) Despite recent statements by Energy Minister Rafael Ramirez that the BRV would nationalize the four strategic associations that produce, upgrade, and market extra heavy crude in the Faja region and that the process was not open to negotiation (Reftel A), all six IOCs met with either Ramirez or Vice Minister Mommer the week of January 15 to begin a process that looks suspiciously like negotiations. All of the companies received a document that set out terms that mirror the conversion of the operating service agreement fields (OSA) to PDVSA controlled joint ventures (Reftels B & C). Key terms such as the value of the investments and PDVSA's ownership percentage were missing. All six companies met separately with BRV officials with the exception of Sincor partners Total and Statoil, which had a joint meeting with Vice Minister Mommer. The four strategic associations are: Sincor (Total 47%, PDVSA 38%, and Statoil 15%),

Petrozuata (ConocoPhillips 50.1%, PDVSA 49.9%), Hamaca (ConocoPhillips 40%, Chevron 30%, and PDVSA 30%) and Cerro Negro (ExxonMobil 41.67%, PDVSA 41.67%, and BP 16.67%). Hamaca is also commonly referred to as Ameriven.

¶3. (C) ConocoPhillips (CP) Business Development and Government Affairs Manager Alex Martinez (strictly protect) told Petatt on January 22 that CP only received a document covering the Hamaca strategic association. It did not receive one for Petrozuata. Martinez opined that the BRV believed it did not need to provide a document for Petrozuata because it is already a joint venture. In addition, the document supplied to CP stated the IOCs in the Hamaca strategic association would pay a bonus to PDVSA for the privilege of migrating their association to a joint venture. (COMMENT: It is not clear if the other IOCs' proposals contained this term. END COMMENT)

¶4. (C) BP Venezuela President Joe Perez (strictly protect) told Petroleum Attache (Petatt) on January 22 that the BRV would provide the companies with estimates on the value of their investments the week of January 29. Perez stated the estimates were being prepared by U.S. attorney George Kahale. (NOTE: Kahale is a partner with New York firm Curtis, Mallet-Prevost, Colt & Mosle. He advised the Energy Ministry (MEP) during the migration of the OSAs to PDVSA controlled joint ventures. END NOTE.) CP's Martinez stated that the BRV requested that CP provide it with information on the incremental costs of each percentage of ownership. For example, CP is to provide the BRV with its valuation of a 53% ownership stake as opposed to a 52% stake.

TIMING

¶5. (C) ExxonMobil Venezuela President Tim Cutt (strictly protect) stated in a brief conversation with Petatt on January 14 that the BRV had presented Exxon with an ultimatum. According to Cutt, Exxon has two weeks to decide if it wishes to continue operating in the Faja. Cutt will meet with Exxon's chairman in Houston to discuss next steps. Exxon appears to be the only company that has been given a time limit. CP's Martinez stated CP had two or three weeks to study the written proposal and respond to it. Martinez, Chevron Latin America President Ali Moshiri, and BP's Perez denied that their companies had received any sort of time limits or ultimatums in conversations with Petatt on January ¶22. Statoil said that BRV interlocutors did not mention any time limits in a January 18 meeting (Reftel D). Perez opined that the BRV would impose time limits on all of the companies but that had not yet occurred. He also believed the entire negotiating process would last six weeks. Both Moshiri and Perez stated they were told by BRV officials that the entire conversion process would take six months.

¶6. (C) COMMENT: It appears that Exxon has not told BP, its Cerro Negro partner about the ultimatum. Perez told Petatt that BP's greatest fear was that Exxon would pull out of Cerro Negro. He stated that Exxon has taken a particularly tough bargaining position. He candidly admitted that at this point BP is basically hiding behind Exxon, a reasonable position given their relative stakes in Cerro Negro. He added the time was rapidly approaching when BP would have to stake out its own position. Perez said he was encouraging his senior management to look at their Venezuelan investments from a long term perspective. END COMMENT.

POSSIBLE STICKING POINTS

¶7. (C) Based on multiple conversations, it is clear that the greatest concern for all of the IOCs is fair compensation for lost value. The second biggest concern appears to be governance issues. Perez noted companies will have a very

hard time accepting the proposition that they will not have a say in how multi-billion dollar investments are operated. Exxon and CP executives have echoed this concern in previous meetings.

¶8. (C) Apart from these two major areas, Perez stated transparency was a major issue for BP. Under the joint ventures that govern the former OSA fields, Perez pointed out that there has been a distinct lack of transparency in how money has been handled. He also complained that BP has not been paid its share of revenues or reimbursed for capital expenditures. He estimated that PDVSA owes its joint venture partners approximately two billion USD.

¶9. (C) When Petatt mentioned that the associations' financing arrangements could pose problems for the MEP and PDVSA, both Perez and Martinez agreed. Perez estimated that the strategic associations have three billion USD in outstanding loans and bonds. Some of the loans and bonds carry severe penalties. Martinez stated some of the bonds carry penalties of 150 percent. According to Perez, BP and Total's financing arrangements will be the easiest for the BRV. BP did not finance any of its investment in Cerro Negro. It merely signed a document that supported Exxon. Under the document, BP pledged to carry out its Cerro Negro obligations in a timely manner. Perez stated Total financed its investment via direct bank loans, which are relatively straightforward. He stated the other four IOC's financial arrangements are far more complicated.

¶10. (C) Martinez stated CP is concerned about safety and labor issues. PDVSA's safety record in its refineries is horrendous and CP believes that its bad practices could infect the association's upgrader operations. In addition, Martinez believes that the upgraders' employees will join unions after the migration, particularly after they see substantial pay cuts. (NOTE: IOC employees that migrated to joint ventures from the former OSA fields in some cases saw substantial pay cuts. END NOTE) The associations' unions, which currently cover contractors, are militant and Martinez worried that they would disrupt upgrader operations.

¶11. (C) Martinez stated CP is also very concerned about supply contracts. Petrozuata and Hamaca currently have supply contracts with two CP refineries in the United States. The BRV has clearly stated PDVSA will control marketing in the new joint ventures. Martinez expressed concern that PDVSA would seek to divert exports away from the United States. He also worried that the new joint ventures would not be able to maintain timely deliveries due to a decrease in operational efficiency.

GAS SECTOR INVESTMENTS

¶12. (C) When asked about the BRV's recent comments about changing the regulatory framework for the gas sector, Moshiri stated he was not concerned. As in the case of Statoil (Reftel D), he believes the BRV will not deal with the gas sector until it had finished with the oil sector. He stated Chevron will honor its gas exploration contract but is slowing down the whole process. He added the BRV has been quite helpful in this regard since it is difficult to get the MEP to make decisions. For example, Chevron has been waiting almost a year and a half for an interim operations agreement.

WHO IS IN THE DRIVER'S SEAT?

¶13. (C) Moshiri, Perez, and Martinez all agree with Statoil (Reftel D) that Vice Minister's influence as a policymaker has waned significantly. Perez stated Mommer told him that he only implemented policy and did not create it. Perez attributed Mommer's declining influence to his less than

stellar handling of the OSA migration. Martinez noted that Mommer seems to be tired. Moshiri opined that the MEP's U.S. attorneys were driving the association negotiations. He claimed the document that Chevron received was clearly drafted by U.S. attorneys.

HANG TOGETHER OR HANG APART

¶14. (C) The six IOCs are currently in close contact with each other regarding the migration but there already appears to be fissures in their united front. Martinez stated "some" of the companies are no longer showing up for meetings on the migration. He added that he did not think the companies would stick together due to differences in corporate cultures. Perez stated five of the six companies were actively sharing information. He complained that Chevron was not acting in a transparent way, and claimed CP executives had also complained about Chevron.

¶15. (C) Moshiri told Petatt he believes some of the companies would no longer have a presence in the Faja after the migration. He did not name names but stated Chevron was the only U.S. company in good standing with the BRV. He also added the BRV was not happy with the European companies. In Moshiri's opinion, 2007 is a key year, and the question is

who will be in Venezuela by year end.

BROWNFIELD